

**COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

**Petition of Boston Edison Company and
Commonwealth Electric Company, d/b/a NSTAR
Electric, for Approvals Relating to the Termination
of Power Purchase Agreements with
MASSPOWER**

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D.T.E. 04-61

**INITIAL BRIEF OF
THE ATTORNEY GENERAL**

Respectfully submitted,

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I. INTRODUCTION

This case concerns a Petition (“Petition”) by Boston Edison Company (“Boston Edison”) and Commonwealth Electric Company (“Commonwealth”), d/b/a NSTAR Electric (the “Company” or “NSTAR Electric”), for Department approval of buyouts of three power purchase agreements (“PPAs”) with MASSPOWER and related rate recovery.

II. PROCEDURAL HISTORY

On July 7, 2004, pursuant to G.L. c. 164, §§1A, 1G, 76, 94 and 94A, NSTAR Electric filed a Petition with the Department for approval of the buyout and termination of the MASSPOWER contracts. On September 8, 2004, the Department conducted a public hearing and a procedural conference to establish a schedule for discovery, hearings and briefs. At this conference, the Department granted limited intervenor status to MASSPOWER, and later, to Massachusetts Municipal Wholesale Electric Company (“MMWEC”) and Cape Light Compact.

The Department conducted an evidentiary hearing on October 20, 2004. During the evidentiary hearing, NSTAR Electric presented two witnesses to testify in support of its proposal, Geoffrey O. Lubbock, Vice President of Financial Strategic Planning and Policy for NSTAR

Electric, and Robert B. Hevert, President of Concentric Energy Advisors, Inc (“CEA”).

III. THE COMPANY’S PROPOSAL

NSTAR Electric has three existing PPAs for the output of the MASSPOWER generating unit: Commonwealth has two (MASSPOWER 1 and MASSPOWER 2) and Boston Edison has one (MASSPOWER BEC). Under each of its PPAs, Commonwealth is entitled to 11.11 percent of the output of the generating unit, with a cap of 29.67 MW in the winter and 25.5 MW in summer. Exh. NSTAR-RBH, pp. 24-25. The MASSPOWER 1 agreement has an initial twenty-year term beginning on July 31, 1993 and ending July 31, 2008 and the MASSPOWER 2 agreement terminates on July 31, 2013. *Id.*, p. 24. Under the MASSPOWER BEC agreement, Boston Edison is entitled to 44.34 percent of the MASSPOWER unit, with caps of 117 MW in the winter and 100 MW in the summer. The MASSPOWER BEC agreement includes a supplemental energy payment and has a twenty-year term beginning January 1, 1994 and ending December 31, 2013. *Id.*, p. 25.

After conducting a 2003 auction for all of the Company’s remaining PPA contracts, including the MASSPOWER contracts, the Company claims that the MASSPOWER buyout offer was the lowest viable bid¹ and created the greatest possible reduction in above-market costs.² *Id.*, p. 22. On June 8, 2004, the Company and MASSPOWER executed the Termination

¹ Working with its consultant CEA, the Company assigned a market value to the MASSPOWER PPAs using variables such as (1) the market price of energy and capacity, (2) the projected energy production, and (3) fuel costs. Exh. NSTAR-RBH, p. 26. CEA used a discount rate of 7.82 percent for the evaluation of these contracts and bids. *Id.*

² The Company calculated above-market costs as the present value of the difference between the expected total cost under the PPA terms and the market value based on the Henwood Energy Service Inc.’s (“Henwood”) Northeast Electricity and Gas Price Outlook for Fall 2003, with updates in March and May, 2004 for years 2004 through 2006 (“Northeast Electric and Gas Price Forecast”). Exh.

Agreement that is the subject of the Company's Petition.

If the Department approves the Termination Agreement, MASSPOWER would relieve the Company of its obligations to purchase or accept electricity produced at MASSPOWER's generating facility. The Company would pay a lump sum to MASSPOWER.³ According to the Company, the proposed Termination Agreements will result in approximately \$67 million in customer savings on a net present value basis.⁴ The Company also asks the Department to approve its proposal to pass the costs relating to the Termination Agreement through the respective transition charges of Boston Edison and Commonwealth.

IV. STANDARD OF REVIEW

The Company is required to seek to mitigate to the maximum extent possible the total amount of transition costs recovered and to minimize the impact of recovery of transition costs on ratepayers. G.L. c. 164 §1G(d)(1) (the "Restructuring Act"). Mitigation efforts in which the Company must engage include (1) "...good faith efforts to renegotiate, restructure, reaffirm, terminate or dispose of existing contractual commitments for purchased power which exceed the competitive market price for power..."; (2) "...examination and analysis of the historic level of performance over the life of such contractual commitments for purchase power, regardless of whether or not they exceed the competitive market price..."; and (3) "...any other mitigation and

NSTAR-RBH, p. 18.

³ The Company has asked the Department for approval to issue rate reduction bonds to finance this payment as well as the payment in another PPA buyout. *See* dockets D.T.E. 04-70 and 04-78.

⁴ The Company's \$67 million savings estimate is based on the Henwood energy forecasts from the spring of 2004. The Attorney General requested and the Department ordered the Company to update the energy forecasts used in its analysis of the contract assignment as well as the determination of the resulting savings. Exh. RR-DTE-6.

analytical activities which the department determines to be reasonable and effective mechanisms for reducing identifiable transition costs.” G.L. c. 164 §1G(d)(1)(ii), (iii), (vi).

According to the Restructuring Act, the Department, beginning July 1, 1998, and at least annually thereafter, shall review purchased power contracts approved on or by December 31, 1995 in order to determine if the contracts contain a price for electricity that is above-market as of the date of review. G.L. c. 164 §1G(d)(2)(i). If the Department determines a contract to be above-market, the electric company and the seller shall attempt to make a good-faith effort to renegotiate the contract in order to achieve further reductions in the transition charge. G.L. c. 164 §1G(d)(2)(i).

When evaluating the divestiture of generation assets, the Department reviews whether the divestiture process was equitable and structured to maximize the value of the assets being sold.

Cambridge Electric Light Company and Commonwealth Electric Company / Pittsfield

Generating Company, L.P., D.T.E. 04-60, p. 21 (2004), *citing Western Massachusetts Electric*

Company, D.T.E. 00-68, p. 12 (2000). The Department has relied on the auction process to

determine whether a transaction involving a non-generating asset maximizes mitigation of

transition costs. D.T.E. 04-60, p. 21 *citing Western Massachusetts Electric Company*, D.T.E. 01-

99, p. 10 (1999) and *Cambridge Electric Light Company*, D.T.E. 01-94, p. 10 (1999). Also, the

Department determines whether a company has indeed maximized the level of mitigation.

Cambridge Electric Light Company/Canal Electric Company/Commonwealth Electric Company,

D.P.U./D.T.E. 97-111, p. 64 (1998). The Department is authorized to approve the recovery of

costs associated with a contract restructuring if the buyout is likely to achieve customer savings

and is otherwise in the public interest. G.L. c. 164 §1G(b)(1)(iv).

The Department must also determine whether the proposed contract termination is reasonable. *See Plymouth Rock Energy Associates, L.P.*, D.P.U./D.T.E. 92-122-B (1999). In assessing the reasonableness of an agreement, the Department must review all available information to ensure that the agreement is consistent with the public interest and complies with the precedent governing buyouts of purchase power contracts. *Commonwealth Electric Company*, D.P.U. 91-200, p. 5-6 (1993); *Boston Edison Company*, D.P.U. 92-183 (1992) (Department approved termination agreement of a purchase power contract with Down East Peat, L.P.).

V. ARGUMENT

The Department should assure that the Company's petition will yield significant savings to customers, maximizing the mitigation of transition costs. The Company bases its analyses of customer savings on variables such as energy costs and the interest rate at which the bonds will be secured. These variables may change significantly before the closing of the Termination Agreement and the necessary securitization. The Department should minimize this risk by capping the interest rate used for the securitized bonds and requiring updates to the Company's Petition based on the Fall 2004 Henwood forecasts.

A. THE DEPARTMENT SHOULD ENSURE THE COMPANY'S PETITION YIELDS A SIGNIFICANT MARGIN OF CUSTOMER SAVINGS.

If the Department approves the Company's Petition, it should ensure that there is a significant margin of savings to customers. Small changes in the assumptions that the Company used to perform its cost analysis dramatically change the net present value savings of the MASSPOWER contract buyout CEA calculated. For example, a 25 percent increase in the

energy cost eliminates the savings in CEA's analysis. RR-DTE-3. Similarly, using a discount rate of just 10.5 percent results in a breakeven analysis where the buyout payment equals CEA's expected costs of holding onto the contract.

Furthermore, a significant portion of the net present value savings from the Company's proposal is derived from the financing of the buyout payment through the securitized bonds. Exh. NSTAR-GOL, p. 15. After the dollar principal amount of the bond issue, the most significant variable determining the savings associated with the securitized bonds is the interest rate. *Id.*, pp. 23-24. The Company bases all of its net present value analyses of the securitized bonds on a 4.50 percent interest rate. *Id.*, p. 23. If the Department approves the Company's proposed securitized bond issuance, the interest rate on the bonds will be determined at the time they are issued. If, as forecasted, interest rates increase (*See Boston Edison Company/Ocean State Power*, D.T.E. 04-68, RR-AG-4 Attachment, p. 1) that will decrease net present value savings to customers. In order to guarantee that there are significant savings to customers from the buyout of these contracts, the Department should cap the interest rate. Without a cap on the interest rate, the estimated savings to customers are, at best, speculative.

By capping the interest rate, the Department would allow a reasonable minimum savings percentage. A reasonable minimum savings percentage would be five percent over the net present value of the expected cash flows required under the contract. A five percent minimum will provide some margin for any errors in the energy forecast and the discount rate used in Mr. Hevert's analysis. The Department should ensure that, with the updates to the Henwood energy forecasts and the updates to the market interest rate for the bond issue, there is still a minimum of a five percent savings rate on the net present value of the expected contract costs. Therefore, if

the Department approves the Company's Petition and the related financing order, it should also cap the interest rate.

B. THE ATTORNEY GENERAL RESERVES THE RIGHT TO SUPPLEMENT THIS BRIEF BASED ON THE COMPANY'S UPDATES TO THE FALL 2004 HENWOOD STUDY.

The Department has asked the Company to provide updated calculations on schedules in its Petition after the Fall 2004 Henwood forecast numbers become available.⁵ Tr. 1, pp. 153-154. These updated calculations may change the Company's Petition in terms of the customer savings. The energy market, including natural gas and oil prices, has changed drastically since the Company performed its analysis last spring. If, as anticipated, there are significant changes in the Fall 2004 Henwood forecast, the Company's calculations and assumptions regarding the estimated customer savings in this case will also change significantly. The Attorney General reserves his right to supplement this brief based on the results of these updates.

VI. CONCLUSION

For these reasons, the Department should ensure the Company's Petition will provide a significant margin of savings to customers.

⁵ According to the Company, the Fall 2004 Henwood forecast will be available October 29, 2004. Exh. AG-1-38. In open record requests, the Department and the Attorney General asked the Company to recalculate Exhibits NSTAR-GOL-BEC-2 through NSTAR-GOL-BEC-8, NSTAR-GOL-COM-2 through 8, NSTAR-RBH-5 and NSTAR-RBH-6 to the extent that these exhibits change due to the Fall 2004 Henwood forecast. Tr. 1, pp. 33-34, 65.

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